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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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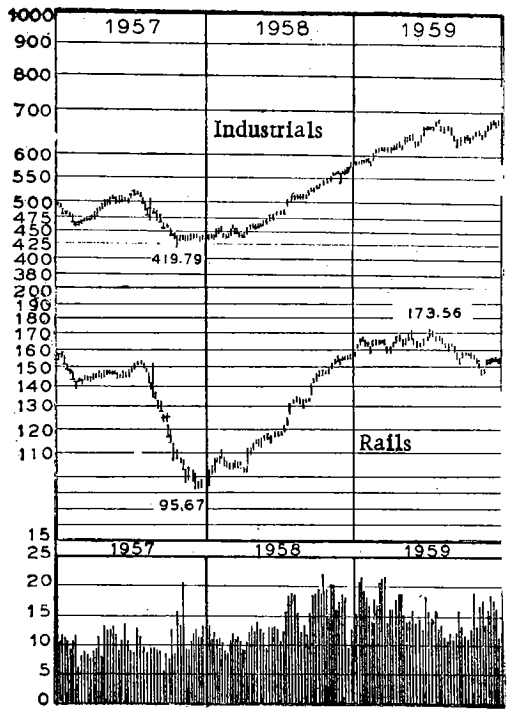
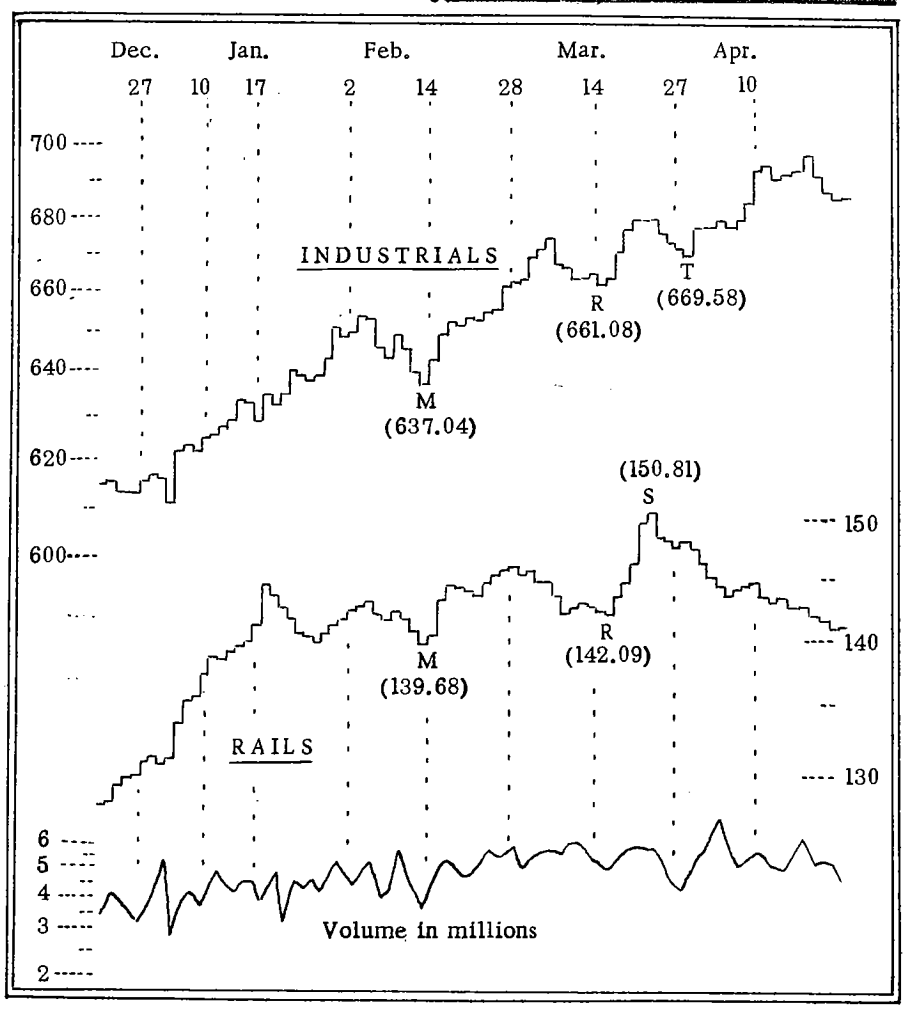


THE MARKET In attending last week's meeting of the N.Y. Society of Security Analysts, I heard three well-known analysts express their opinions regarding the market outlook. All three men talked in terms of "800 or better for the Dow" over the foreseeable future. I must admit that this professional unanimity of opinion gave me a rather uncomfortable feeling. I have termed this market "a hunting ground for speculators", and I continue to think along those lines. As far as preconceived notions as to what "the market will do over the next year", I have none. When the Averages bettered their previous secondary highs I stated that the presumption was strong that the primary trend had turned bullish. Nothing since then has reversed those primary indications.

The last few Letters have drawn attention to the Rail divergence. The declining tendency of the Rails has occurred in a particularly interesting area -- namely, the general area of the 1959 and 1960 Industrial peaks. Many analysts are now comparing "the coming advance" with the one which occurred in 1958-59 following the hurdling of the 1956-57 "triple-top". These comparisons could be well taken, but something new has already been added -- the Rail weakness.

I have included a chart of the 1957-59 period, and here we see the amazing 259 point Industrial advance. Note that when the Industrial Average bettered the 521 triple-top level (September, 1958), the Rails continued to advance "in gear", and the carriers showed no signs of hesitancy until January, 1959.



In the present situation the

difference is worth noting. The Industrial Average bettered its 1960 peak of 685.47 on April 10, 1961. But Rails touched their peak of 150.81 on March 22 (twelve trading days earlier), following which the Rails retreated steadily despite new Industrial highs.

Thus a "tug-o'-war" has been going on between the two Averages. In the period since March 22 (S) the Rails have persistently declined, and by last week the carriers had succeeded in wiping out almost all of the gains established on the M-S advance. In the face of this, Industrials turned weak on April 17, and they have been drifting down (on relatively low volume) since that time.

This Letter contains two studies of market breadth, both of which suggest that the general market is "tired". Under normal conditions a sharp decline or a reaction would definitely be expected in this area. If such a movement is now underway it will be important to observe the action of Industrials as they approach their preceding decline low at T (669.58). Regardless of further possible Rail weakness, if Industrials can hold above T (as volume dries up) the implication will be that another advance is in the offing. Conversely, a violation of 669.58 on increased volume would appear bearish and would suggest that the secondary trend had turned down.

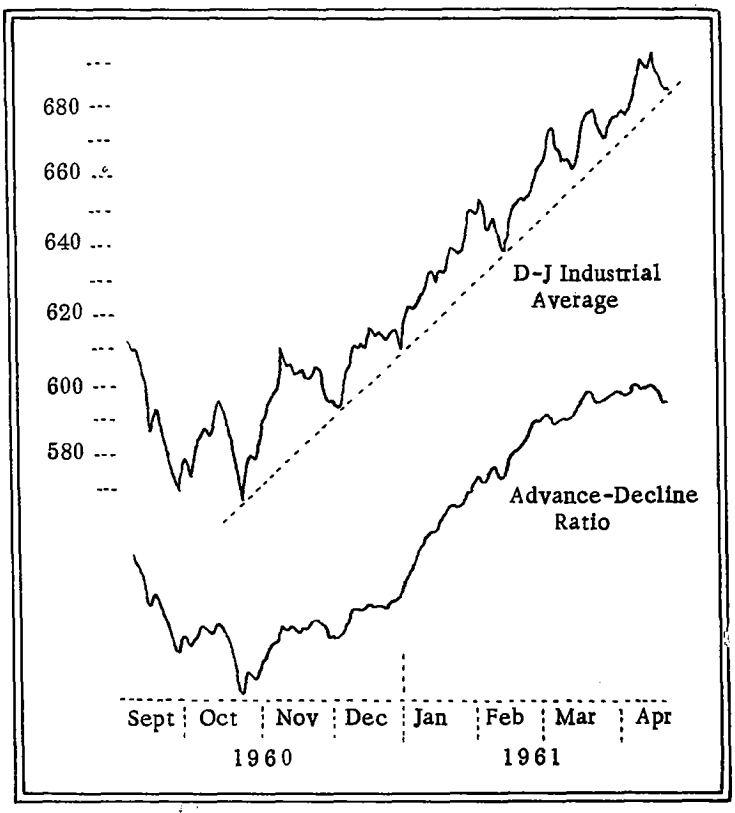
Odd-lot selling stubbornly continues. On April 19 Industrials dropped 4.39 points, and the odd-lot ratio jumped to 110 (11 shares sold for every 10 bought), which is the highest rate of selling since March 24. This persistent odd-lot selling is the biggest technical plus in the market at this time.

The short interest ratio in April fell to .69. This is the lowest figure since June, 1948 (.67). In 1948 the .67 figure appeared at the peak of the "baby" bull market which began in 1947. As mentioned before, the S.I. Ratio cannot identify the absolute peak of a movement, it can only serve to point out broad areas of danger. History shows that the .50 to .75 area is dangerous, anything under .50 is an absolute "sell zone".

"BREADTH" Letter 140 stated: "Since March the advance-decline ratio seems to have lost much of its momentum, and it now has the appearance of a possible 'rounding over'. This could be the first sign of weakness in the general market".

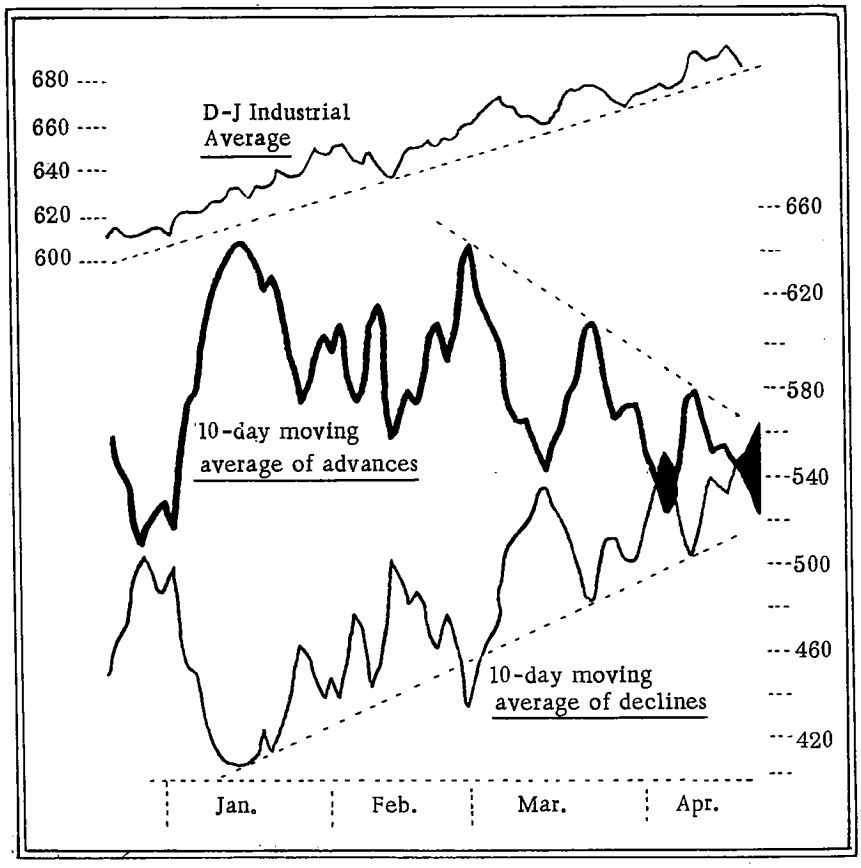
I have included charts which provide two dimensions for measuring the action of the broad market as compared with the D-J Industrial Average. The first chart shows the advance decline ratio, a measurement which has been discussed many times before in these Letters. This is simply the total of daily declines subtracted from total advances (vice versa if there were more declines than advances), with the remainder divided by the total number of issues traded. The resultant ratio is added to the previous day's total if there were more advances than declines, subtracted if there were more declines than advances.

Note that the Industrial Average has held to a very obvious trendline during the entire advance since October, 1960. Up to mid-March the advance-decline ratio (or the broad market) had advanced perfectly "in gear" with Industrials. Then, starting in mid-March (while Industrials continued to new highs) the advance-decline commenced to round over, and it was



apparent for the first time that the general market, while not actually diverging in direction with the Industrial Average, was "losing its steam".

The second breadth study has not been presented in these Letters before. Basically, this is a profile of daily advances and declines compared with the movements of the D-J Industrials. So that trends in advances and declines can be more easily detected, a ten day moving average of advances and a ten-day moving average of declines is used. (The heavy black line represents advances, thin black line represents declines, solid black denotes area where declines outnumber advances).



Note that advances (or buying power) touched a peak in mid-January and again in early March, but since March (despite the fact that the Industrial Average was working steadily higher), the moving average of advances has continued to drop lower. By the same token the moving average of declines (selling pressure) has slowly risen, and there was a temporary crossing (black area) in early April. On April 18 the decline line again rose above the advance line, and this means that selling pressure has again risen above buying power. It also shows that since mid-January less and less stocks have been participating in the upward move.

At best such action (in the past) has been a forerunner of periods of consolidation wherein the market works off an "overbought" condition. At worst we could expect a severe decline or reaction, in which case our first definite danger signal would be an Industrial violation of T (669.58) on sharply increased volume.

QUESTION Can the market immediately reverse to the upside despite the fact that the trend of advances and declines has "overlapped" as shown on the chart.

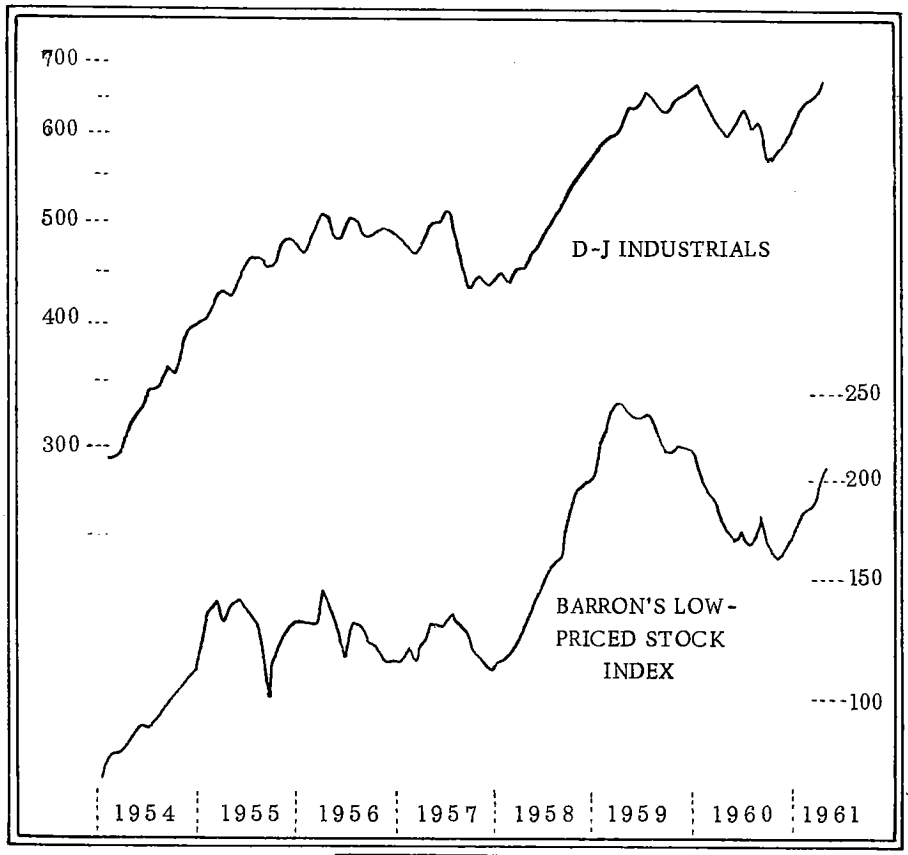
ANSWER Yes, this can occur, but if it does I would consider the rise extremely dangerous and subject to a reversal at any time. It would be far healthier if a period of reaction or consolidation appeared at this time. Following such a period an excellent "buy-spot" might be identified.

LOW-PRICED STOCKS There is a very real difference between today's low-priced "new issue" and the old fashioned "cat-and-dog" (as represented by the stocks in Barron's or Standard & Poor's low-priced stock averages). Today's new issues are being bought because purchasers are finding an immediate market for them which (at least for a time) is above the issuing price, and because it is hoped that each new issue will be "another Texas Instruments". But the old fashioned cat-and-dog (such as Hupp Corp, Avco, Sparton Corp.) seems to be subject to a definite cycle. Such stocks may lie dormant throughout the greatest part of a bull market, then double or triple in price as a bull market enters its final, speculative phase. During this last phase the public will comb the lists for stocks which are still "cheap" or stocks that seem behind the market. After the market "tops out" the cats-and-dogs will sink back into oblivion to await buying and accumulation for the next bull market cycle.

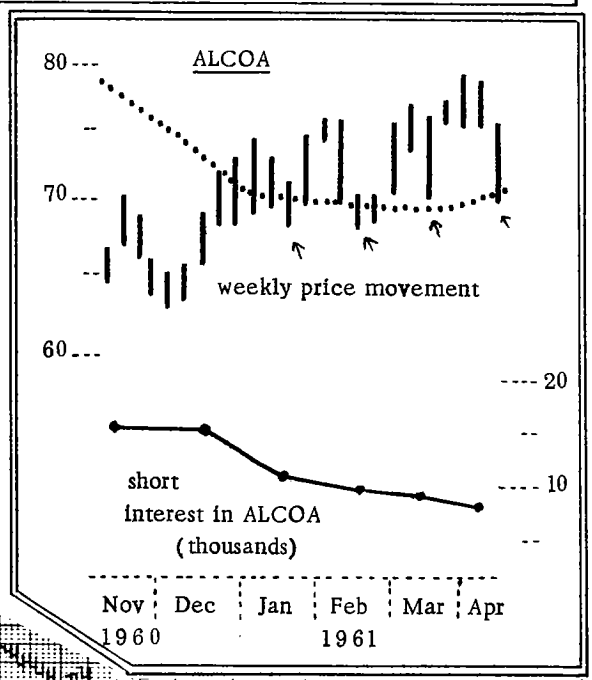
In July, 1958, Barron's Low-Priced Index bettered its previous 1956 high and began an almost vertical advance which did not end until April, 1959. But it was not until September, 1958, that the D-J Industrial Average bettered its old 521 "triple-top".

In the present situation the Industrial Average has marched into new high ground. But so far, Barron's Low-Priced Index has been lagging, and it is still 37 points below its 1959 high. If the current bull market is going to last as much as four to six months longer, it would seem almost certain that Barron's Low-Priced Stock Index will climb to a new high above the 250 peak of 1959. But if Barron's Index shows signs of weakness or resistance to a further rise, we will have a danger signal worth watching. One of

the earliest warning signals in 1959 was the April "topping" of the low-priced stock indices together with the declining advance-decline ratio.



STOCKS The relationship of a stock to its own moving average is always an interesting one, but during a sharp decline it is often difficult to determine whether a stock is "testing" or "topping". The chart of ALCOA shows the stock rising above its 30-week moving average (dotted line) in January, 1961. Following the initial upward penetration there have been four separate "tests" of the moving average (arrows). Following the first three tests higher prices were immediately forthcoming. On last week's dismal earnings report ALCOA plunged to 70 (the moving average now stands at 70 3/4), but the stock rose to close the week at 74. Here the moving average (it seems to me) was of great use. The stock, despite adverse news, would not close below 70 3/4, and this was a guide which should have given comfort to holders of ALCOA. Of less comfort is the trend of the short position in ALCOA. It has been working gradually lower, and this trend is typical of most of the stocks in the D-J Industrial Average.



The daily chart shows the long decline in General Electric (almost identical to Westinghouse). Note the heavy volume which began in January and the "gapping" downside action in February, which coincided with the Government price-fixing suits. The violent February downside action was of the panicky variety, and the stock's action since then has been quite typical. The stock rallied sharply and has now returned to the area of the lows, as if to "check its wounds". There would seem to be a good trading play in G.E. The low of the move was 61 1/8 (Westinghouse's low was 40 5/8). Those who buy it here will be buying almost at the preceding bottom. Stock purchased here could be sold with but small loss if a new low of say 59 is recorded on a closing basis. Otherwise, subsequent developments might identify the present area as a powerful "double bottom". (Chart of G.E. courtesy of Traders Research, P.O. Box 6185 Lambert Airport, Missouri)

Weekend developments in France and Cuba have been blamed for the Monday morning drop in prices. But as shown on the breadth studies, the odds favored lower prices anyway. For this reason I would be extremely selective about any commitments at this time. The first reaction of many people will be "to buy 'em on the 'scare' news". This can be costly if the scare news coincided with a market which is also ripe for a correction.